

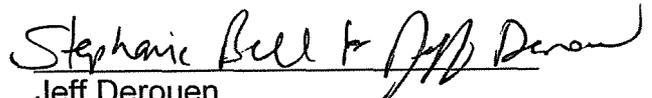
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTHEAST DAVIESS)
COUNTY WATER DISTRICT FOR THE APPROVAL) CASE NO. 2011-00481
OF A PROPOSED INCREASE IN RATES AND)
WATER SERVICE)

NOTICE OF FILLING OF COMMISSION STAFF REPORT

Pursuant to the Commission's Order of December 22, 2011, Commission Staff files the attached report containing its findings and recommendations regarding the Applicant's proposed rate adjustment.


Jeff Derouen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED: JAN 30 2012

cc: Parties of Record

REPORT ON THE PROPOSED RATE ADJUSTMENT OF
SOUTHEAST DAVIESS COUNTY WATER DISTRICT

CASE NO. 2011-00481

On December 12, 2011, Southeast Daviess County Water District ("Southeast Daviess") filed with the Commission an application to adjust its current rates for water service. Using its historical operations for the calendar year ended December 31, 2010 and adjusting for known and measureable changes, Southeast Daviess proposes rates that will reportedly produce additional revenues from water sales of \$186,286, an increase of 10.5 percent over pro forma revenues from water sales. For a customer who purchases 5,000 gallons of water monthly, his monthly bill will increase from \$17.71 to \$19.97, or approximately 12.2 percent.

Commission Staff members Darryl Parks and Eddie Beavers performed a limited financial review of Southeast Daviess's test year operations to determine whether test period operating revenues and expenses are representative of normal operations and the proposed adjustments are reasonable.¹ They did not pursue and have not addressed in this report insignificant or immaterial discrepancies. Where they have not expressly addressed a test period expense, they found insufficient evidence to contest the reasonableness of that expense.

This report summarizes Staff's review and recommendations. Mr. Beavers reviewed Southeast Daviess's pro forma revenue adjustment, its Cost-of-Service Study, and its calculation of the recommended rates. Mr. Parks addresses all pro forma expense adjustments and the revenue requirement determination.

¹ Mr. Parks and Mr. Beavers inspected Southeast Daviess's records while assisting Southeast Daviess in the preparation of its rate application.

Commission Staff finds that Southeast Daviess's application accurately reports its test-period operations and its proposed pro forma adjustments generally meet the rate-making criteria of known and measurable. Southeast Daviess's pro forma operating income statement is set forth in Appendix A. In Appendix B, Commission Staff explains each pro forma adjustment that it proposes.

The Commission has historically used the Debt Service Coverage ("DSC") methodology to determine the revenue requirement for water districts. This approach is used primarily because a bond ordinance or loan agreement requires the water district or association to maintain a predetermined DSC level. Commission Staff, however, does not recommend the use of this methodology in this case because Southeast Daviess has only one outstanding long-term debt and uses the proceeds of a surcharge to retire this debt.

Commission Staff instead recommends that the operating ratio methodology be used to calculate Southeast Daviess's revenue requirement.² This approach is used when there is no basis for a rate-of-return determination, the cost of the utility has fully or largely been funded through contributions, or there is little or no outstanding long-term debt. Commission Staff is of the opinion that an operating ratio of 88 percent will allow Southeast Daviess sufficient revenues to cover its reasonable operating expenses, and provide for reasonable equity growth.

² Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

As shown in Table 1, applying an 88 percent operating ratio to Commission Staff's proposed pro forma operations produces a revenue requirement from rates of \$1,950,070, an increase of \$175,435 or 9.89 percent above the normalized revenue from rates of \$1,774,635.³

Table I: Revenue Requirement Determination		
Net Pro Forma Operating Expenses	\$	1,828,810
Divided by: Operating Ratio	÷	88%
Subtotal	\$	2,078,193
Add: Interest Expense	+	2,485
Total Revenue Requirement	\$	2,080,678
Less: Other Income & Deductions	-	34,607
Revenue Requirement from Operations	\$	2,046,071
Less: Other Operating Revenues	-	96,001
Revenue Requirement - Water Sales	\$	1,950,070
Less: Pro Forma Revenue - Water Sales	-	1,774,635
Requested Increase	\$	175,435
Percentage Increase		9.886%

Based upon adjusted test-period water sales, Southeast Daviess's proposed rates will produce revenues of \$1,960,921. Southeast Daviess has submitted a cost-of-service study that supports these rates. The methodology that Southeast Daviess used in its cost-of-service study is consistent with methodologies that the Commission has previously accepted. As Southeast Daviess's proposed rates will generate revenues in excess of Commission Staff's recommended revenue requirement, Commission Staff recommends that the Commission deny the proposed rates and instead authorize the rates set forth in Appendix C.

³ In determining Southeast Daviess's revenue requirement, Commission Staff did not consider any proceeds from a surcharge of \$0.39 per 1,000 gallons that the water district assesses on all water sales. The proceeds of this surcharge may only be used to repay a 2008 loan from the Kentucky Infrastructure Authority. Expenses related to this loan have been excluded from Commission Staff's revenue calculation.

Signatures



Prepared by: Daryl Parks
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis



Prepared by: Eddie Beavers
Rate Analyst, Communications, Water
and Sewer Rate Design Branch
Division of Financial Analysis

APPENDIX A
STAFF REPORT CASE NO. 2011-00481
PRO FORMA OPERATIONS

	2010 Annual Report	Proforma Adjustment	Adj. Ref.	Pro Forma Operations
Operating Revenues:				
Revenue - Metered Water Sales	\$ 1,850,304	\$ (75,669)	(a)	\$ 1,774,635
Revenue - Fire Protection	9,116	0		9,116
Revenue - Irrigation Customers	2,598	0		2,598
Total Sales of Water	\$ 1,862,018	\$ (75,669)		\$ 1,786,349
Other Operating Revenues:				
Forfeited Discounts	\$ 22,791	\$ 0		\$ 22,791
Miscellaneous Service Revenues	24,790	0		24,790
Miscellaneous Service Revenues	36,706	0		36,706
Total Other Operating Revenues	\$ 84,287	\$ 0		\$ 84,287
Total Operating Revenues	\$ 1,946,305	\$ (75,669)		\$ 1,870,636
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages - Employees	\$ 297,238	\$ 11,399	(b)	\$ 308,637
Salaries & Wages - Commissioners	9,000	0		9,000
Employee Pension & Benefits	122,708	10,209	(c)	132,917
Purchased Water	978,788	(72,617)	(d)	906,171
Purchased Power	42,341	0		42,341
Materials & Supplies	112,920	(12,300)	(e)	100,620
Contractual Services - Eng	757	0		757
Contractual Services -				
Accounting	6,600	0		6,600
Contractual Services - Testing	6,390	0		6,390
Rental Real Building/Real. Prop	5,315	0		5,315
Transportation	26,481	0		26,481
Insurance - Gen. Liability	19,105	2,525	(f)	21,630
Insurance - Workers				
Compensation	5,382	(107)	(g)	5,275
Advertising	295	0		295
Bad Debt Expense	7,281	0		7,281
Miscellaneous	13,490	0		13,490
Total Operation & Maintenance	\$ 1,654,091	\$ (60,891)		\$ 1,593,200
Depreciation	208,778	1,510	(h)	210,288
Taxes Other Than Income:				
Payroll Taxes	22,567	(62)	(i)	22,505
PSC Assessment	2,817	0		2,817
Utility Operating Expenses	\$ 1,888,253	\$ (59,443)		\$ 1,828,810
Net Utility Operating Income	\$ 58,052	\$ (16,226)		\$ 41,826
Other Income & Deductions:				
Interest Income	34,607	0		34,607
Interest Expense	13,336	(10,851)	(j)	2,485
Net Income Available for Debt Service	\$ 79,323	\$ (5,375)		\$ 73,948

**APPENDIX B
STAFF REPORT CASE NO. 2011-00481
PRO FORMA ADJUSTMENTS**

(a) Revenue from Water Sales: This adjustment reflects the results of Commission Staff's billing analysis and the current rate schedule. On June 1, 2011, Southeast Daviess adjusted its rates downward pursuant to 807 KAR 5:068 to reflect a reduction in the wholesale rate of Owensboro Municipal Utilities from \$1.62 per 1,000 gallons to \$1.50 per gallons of water. Normalizing for this rate reduction results in a reduction of revenue of \$75,669.

(b) Salaries & Wages: As a cost savings measure, West Daviess WD and Southeast Daviess WD share staff. Therefore, all payroll related costs are allocated to each District using a 45/55 ratio. The Districts' allocation factors are based upon the ratio of Utility Plant In Service and the ratio of revenues. When the Districts' performed their calculations, both ratios produced similar results. Commission Staff reviewed the 2010 ratios, which support the 45/55 allocation used in the test period. Staff is applying the 2011 wages to the hours worked during the 2010 test period and applying the 45/55 allocation.

	Utility Plant	Revenues	Averages
Southeast Daviess	\$ 9,242,335	\$ 1,862,018	
West Daviess	+ 9,034,978	+ 1,321,803	
Totals	\$ 18,277,313	\$ 3,183,821	
Southeast Daviess – Ratio	50.567%	58.484%	54.526%
West Daviess – Ratio	49.433%	41.516%	45.475%
Totals – Ratio	100.000%	100.000%	100.000%

Employee		Payment Method	Wage Rates		2010 Overtime Hrs.	Pro Forma Salaries
			Regular			
Perry	Higdon	Hourly	\$ 25.72		225.50	\$ 62,403
Patty	Anderson	Hourly	24.91		0.00	52,012
Nick	Horsman	Hourly	16.89		121.00	38,332
Billy	Higdon	Salary	3,796.08		0.00	91,106
Jeff	Johnson	Hourly	20.18		37.50	43,271
Adam	Mills	Hourly	12.56		0.00	26,225
Beth	Frey	Hourly	13.21		0.50	27,592
Keith	Krampe	Salary	2,912.67		0.00	69,904
Tommy	Cecil	Hourly	20.18		72.00	44,315
Teresa	Doyle	Hourly	12.81		0.00	26,747
Gail	Carlock	Hourly	12.86		0.00	26,852
Sabrina	Baker	Hourly	13.20		0.50	27,572
Laura	Broakley	Hourly	11.89		0.00	24,826
					457.00	\$ 61,157

	West Daviess WD	Southeast Daviess WD
Pro Forma Salaries & Wages - Employees	\$ 561,157	\$ 561,157
Multiplied by: Allocation Factors	45%	55%
Allocated Pro Forma Salaries & Wages - Emp.	\$ 252,521	\$ 308,636
Less: Reported Salaries & Wages - Employees	243,906	297,238
Pro Forma Adjustments	\$ 8,615	\$ 11,398

(c) Employee Pension and Benefits: Commission Staff's adjustment is based upon the current employer retirement contribution rate, the pro forma salaries and wages, the current employee insurance premiums, and the 45/55 allocation between the two districts.

Employee		Employee Insurance Benefits			Employee	Totals
		Health Insurance	Dental MO	Life & Disability	Retirement 11.00%	
Patty	Anderson	8,552	444	\$ 359	\$ 6,864	\$ 16,219
Sabrina	Baker	14,004	231	217	5,721	20,173
Laura	Broakley	19,913	231	215	4,217	24,576
Gail	Carlock	7,947	231	175	10,022	18,375
Tommy	Cecil	20,226	695	303	4,760	25,984
Teresa	Doyle	16,796	444	200	2,885	20,325
Beth	Frey	8,398	231	185	3,035	11,849
Billy	Higdon	17,879	695	576	7,689	26,839
Perry	Higdon	14,004	695	386	4,875	19,960
Nick	Horsman	15,482	444	204	2,942	19,072
Jeff	Johnson	4,826	231	232	2,954	8,243
Keith	Krampe	20,226	695	321	3,033	24,275
Adam	Mils	2,649	231	168	2,731	5,779
		\$ 170,902	\$ 5,498	\$ 3,541	\$ 61,728	\$ 241,669

Pro Forma Salaries & Wages - Employees
Less: Reported Salaries & Wages - Employees
Allocated Pro Forma Salaries & Wages - Emp.
Less: Reported Salaries & Wages - Employees
Pro Forma Adjustments

West Daviness WD	Southeast Daviness WD
\$ 241,669	\$ 241,669
45%	55%
\$ 108,751	\$ 132,918
100,224	122,708
\$ 8,527	\$ 10,210

(d) Purchased Water: Commission Staff applied the current water rate being charged by the Owensboro Municipal system to the test-period water purchases.

Owensboro Municipal Water & Sewer System

Service		Meter # 31963782	Meter # 31963928	Meter # 70084591	Total
From	To	Gallons	Gallons	Gallons	Gallons
12/30/09	01/29/10	35,143,000	9,722,800	2,090,000	46,955,800
01/29/10	02/26/10	28,128,000	10,524,500	1,890,000	40,542,500
02/26/10	03/31/10	28,178,000	8,537,900	1,889,000	38,604,900
03/31/10	04/30/10	30,349,000	7,921,000	1,942,000	40,212,000
04/30/10	05/28/10	30,489,000	11,104,100	1,005,000	42,598,100
05/28/10	06/30/10	28,489,000	14,143,200	1,804,000	44,436,200
06/30/10	07/30/10	35,201,000	24,601,500	3,887,000	63,689,500
07/30/10	08/31/10	34,193,000	19,593,800	8,280,000	62,066,800
08/31/10	09/30/10	36,348,000	22,465,900	8,117,000	66,930,900
09/30/10	10/29/10	33,917,000	17,620,000	7,896,000	59,433,000
10/29/10	11/30/10	32,426,000	14,592,300	5,487,000	52,505,300
11/30/10	12/30/10	34,514,000	6,248,100	5,377,000	46,139,100
Totals		387,375,000	167,075,100	49,664,000	604,114,100

Total Gallons Purchased	604,114,100
Multiplied by: Current Rate per 1,000 Gallons	\$ 1.50
Pro Forma Purchased Water Expense	\$ 906,171
Less: Reported Purchased Water Expense	978,788
Pro Forma Adjustment	\$ (72,617)

(e) Materials & Supplies: This adjustment removes capital items that were incorrectly expensed in the test period.

Vendor	Description	Amount
ITM Inc.	Meter Change Out - 344 Meters at \$10	\$ (3,440)
ITM Inc.	Meter Change Out - 133 Meters at \$10	(1,330)
ITM Inc.	Meter Change Out - 245 Meters at \$10	(2,450)
ITM Inc.	Meter Change Out - 261 Meters at \$10	(2,610)
ITM Inc.	Meter Change Out - 247 Meters at \$10	(2,470)
Total Capital Expenditures		\$ (12,300)

(f) Insurance: Commission Staff is adjusting general liability insurance expense to reflect the current premium.

KACo All Lines Fund 07/01/11 - 07/01/12	21,630
Less: Reported Expense	19,105
Pro Forma Adjustment - General Liab.	\$ 2,525

(g) Workers' Compensation Insurance: Commission Staff is adjusting workers' compensation insurance expense to reflect the current premium.

KACo Workers Compensation Fund 07/01/11 - 07/01/12	\$ 9,590
Multiplied by: Allocation Factors	55%
Allocated Workers Compensation Premium	\$ 5,275
Less: Reported Workers Compensation Premium	5,382
Pro Forma Adjustment - Workers Comp.	(107)
Pro Forma Adjustment - Insurance	\$ 20,248

(h) **Depreciation:** This adjustment reflects a full-year of depreciation for items capitalized in 2010; the removal of two Chevy trucks that are fully depreciated and depreciating items that were incorrectly expensed.

	Test Period		Depreciation		
	Dep Exp	Cost	Life	Expense	Adjustment
(1) Normalized Depreciation (Full Year):					
Ice Maker	\$ 87	\$ 1,458	7	\$ 208	\$ 121
Improvements	\$ 3	\$ 1,325	40	\$ 33	30
Bypass Ext	\$ 800	\$ 63,976	40	\$ 1,599	799
Line Additions	\$ 2,656	\$ 212,458	40	\$ 5,311	2,655
Meters	\$ 1,836	\$ 73,428	40	\$ 1,836	0
Touch Read	\$ 3,098	\$ 123,915	20	\$ 6,196	3,098
Touch Read	\$ 26	\$ 1,053	20	\$ 53	27
Touch Read	\$ 19	\$ 752	20	\$ 38	19
Hydrants	\$ 272	\$ 21,750	40	\$ 544	272
Touch Software	\$ 113	\$ 750	5	\$ 150	38
Touch Hardware	\$ 535	\$ 4,013	5	\$ 803	268
Trailer	\$ 27	\$ 248	7	\$ 35	8
Lawn Mower	\$ 380	\$ 3,544	7	\$ 506	126
(2) Items Fully Depreciated in Test-Period					
Chevy Truck	\$ 3,880	\$ 19,400	5		(3,880)
Chevy Truck	\$ 2,689	\$ 13,447	5		(2,689)
(3) Items Expensed in Test-Period:					
Change Out - 344 Meters		\$ 3,440	20		172
Change Out - 133 Meters		\$ 1,330	20		67
Change Out - 245 Meters		\$ 2,450	20		123
Change Out - 261 Meters		\$ 2,610	20		131
Change Out - 247 Meters		\$ 2,470	20		124
Pro Forma Adjustment					<u>\$ 1,510</u>

(i) **Payroll Taxes:** Commission Staff is applying the payroll tax rate to the normalized salaries and wages expense, and the 45/55 allocation between the two districts..

Employee		Pro Forma Payroll	FICA 7.65%
Perry	Higdon	\$ 62,403	\$ 4,774
Patty	Anderson	52,012	3,979
Nick	Horsman	38,332	2,932
Billy	Higdon	91,106	5,814
Jeff	Johnson	43,271	3,310
Adam	Mils	26,225	2,006
Beth	Frey	27,592	2,111
Keith	Krampe	69,904	5,348
Tommy	Cecil	44,315	3,390
Teresa	Doyle	26,747	2,046
Gail	Carlock	26,852	2,054
Sabrina	Baker	27,572	2,109
Laura	Broakley	24,826	1,899
Pro Forma Totals		<u>\$ 561,157</u>	<u>\$ 41,772</u>

	West Davieess WD	Southeast Davieess WD
Pro Forma Payroll Taxes	\$ 41,772	\$ 41,772
Multiplied by: Allocation Factors	45%	55%
Allocated Pro Forma Payroll Taxes	\$ 18,797	\$ 22,975
Less: Reported Payroll Taxes	18,957	23,037
Pro Forma Adjustments	\$ (160)	\$ (62)

(j) **Interest Expense:** Of total interest expense during the test period, \$10,851 was incurred as a result of the KIA loan. As Southeast Davieess finances the debt service on this loan through a surcharge on all customers, this interest expense should not be considered in determining revenue requirements from water sales.

APPENDIX C
STAFF REPORT CASE NO. 2011-00481
STAFF'S RECOMMENDED RATES

Customer Charge:	
5/8"x3/4" Meter	\$2.53
1" Meter	\$3.54
1 1/2" Meter	\$4.55
2" Meter	\$7.34
3" Meter	\$27.83
4" Meter	\$35.42
6" Meter	\$53.13
8" Meter	\$73.37
Volumetric Rate:	
First 20,000	\$3.44
Over 20,000	\$2.59
Wholesale Rate	\$1.85

Keith Krampe
Southeast Daviess County Water District
3400 Bittel Road
Owensboro, KY 42301